*United States Court of Appeals*

*for the Second Circuit*

# APPELLEE'S BRIEF

# 75-7701

ORIGINAL

*To be argued by*
BERTRAM BRONZAFT

In The

## United States Court of Appeals

For The Second Circuit

ESTHER JACOBY,

*Plaintiff-Appellee-Appellant,*

*vs.*

ALFRED B. AVERELL, CHARLES M. EDWARDS, JR., DONALD B. GOMES, ALVIN C. MARTIN, SOLOMON ROGOFF, STANLEY SIMON, HORACE R. ZIMMERMAN, FREDERICK ZISSU and VORNADO, INC.,

*Defendants-Appellants-Appellees.*

*On Appeal from Final Order and Judgment of the United States District Court for the Southern District of New York, Sat Below, Lawrence W. Pierce, U.S.D.J.*

## BRIEF FOR PLAINTIFF-APPELLEE-APPELLANT



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2. Did the District Court err in awarding plaintiff's counsel a fee of $10,000, or approximately $30 per hour for the hours expended, after a successful prosecution of a stockholders' derivative action?

## STATEMENT

This is an appeal by the plaintiff from so much of a final order and judgment of the United States District Court, Southern District of New York (Pierce, J.) which provides for the payment by Vornado, Inc. ("Vornado") of $10,000 as fees to plaintiff's counsel and accountants for the services rendered by them in the prosecution of the within stockholders' derivative action. (186a-187a*)

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* 'a' refers to pages of 'Appendix'.

This is a stockholders' derivative action brought on behalf of Vornado against a number of its officers and directors alleging that the amendment of 283,500 options by Vornado's management violated the terms of Vornado's 1968 Stock Option Plan ("Plan") and that said amendments and the disclosure thereof were violative of Sections 10(b) and 14 of the Securities Exchange Act of 1934, SEC Rule 10b-5 promulgated thereunder and the common law.

After a trial of the action on Stipulated Facts, Judge Lawrence W. Pierce found the amendment to be in violation of the terms of Vornado's Plan and held the options granted pursuant to the amendment to be null and void. (34a-50a) After an accounting determined that options on 168,000 shares had been voided as a result of plaintiff's action, Judge Pierce directed that a hearing be held before then Magistrate, now Judge, Gerard L. Goettel on the issue of fees to be awarded plaintiff's attorneys and accountants for the services they rendered in the prosecution of the action.

Magistrate Goettel in his June 25, 1975 Report and Recommendation determined that plaintiff's attorneys and accountants had conferred a substantial benefit upon Vornado but that because no cash fund had been created, an admittedly low fee of $10,000 be awarded rather than the $40,000 requested

by plaintiff. (156a-165a)

Despite motions to disaffirm by both sides, Judge Pierce adopted both the reasoning and the recommendation of Magistrate Goettel and awarded plaintiff's counsel $10,000 in legal fees. (179a-185a)

Plaintiff appeals from so much of the Judge Pierce's order and judgment that awards plaintiff $10,000 and not the $40,000 plaintiff had requested in fees, whereas Vornado appeals from so much of the judgment that awards plaintiff $10,000, urging that no fee be awarded at all.

Plaintiff's appeal involves a strong public policy consideration that the District Court seemingly gave no cognizance to, or it would not have awarded counsel a fee which computes to an hourly rate of approximately $30. an hour.

Stockholders' suits have long been lauded by the Courts for the benefits they confer upon corporations and their stockholders and the social good they accomplish. However, in order for counsel, who operate solely upon a contingency basis, to undertake difficult, risk-laden and time consuming litigation, they must be assured that success in such litigation will reward them with fair and reasonable compensation for their services.

The award of a $30 per hour fee to successful counsel can only discourage and deter the institution of stockholders' derivative actions, as no attorney working on a contingency can afford successes such as this and long stay in the practice.

## THE FACTS

On April 16, 1968 the Board of Directors of Vornado, a Delaware corporation, adopted the Vornado 1968 Qualified Option Plan. (8a, 19a) The Plan required stockholder approval in order to qualify as a qualified stock option plan under the Internal Revenue Code of 1954.(17a) The stockholders approved the Plan at the annual meeting on June 8, 1968. (8a, 20a)

Pursuant to the terms of the Plan, Vornado was authorized to grant options to its key employees to purchase no more than 297,000 shares of Vornado's common stock. (21a)

During the period running from July 1968 to and until January 15, 1970, Vornado granted options to purchase 283,500 shares of Vornado's common stock at prices

ranging from $23.00 to $25.07 per share. (8a, 21a)

On January 16, 1970, Vornado's Board of Directors, without prior stockholder approval, amended the option agreements outstanding under the Plan so as to permit the exercise of the options to purchase Vornado shares at a price of $14.69 per share. (8a, 21a) The amendment provided, however, that the said options could only be exercised at $14.69 per share commencing with the expiration of the original option agreements and to terminate on January 15, 1975. (8a)

The complaint alleged that the January 16, 1970 amendment was null and void because the 1968 Plan specifically provided that Vornado's Board of Directors could not, without shareholder approval, modify the options so that they would be exercised at a price less than the fair market value on the date they were granted, or modify said option to extend the period during which the option could be exercised for a period in excess of five years. (9a)

The complaint alleged that subsequent to the amendment, Vornado's common stock sold on the New York Stock Exchange at prices in excess of $29.37 per share. (10a)

Plaintiff further alleged in her complaint that the January 16, 1970 options were null and void because

there was no consideration for the modifications and that at least 50% of Vornado's Board of Directors were optionees-beneficiaries of the January 16, 1970 modifications. (9a)

The complaint alleged that the acts complained of violated Sections 10(b) and 14 of the Securities Exchange Act of 1934 ("Act"), SEC Rule 10(b)-5 promulgated thereunder and the common law. (11a-13a)

The plaintiff sought judgment to hold the January 16, 1970 modification of the options to be null and void; enjoin the exercise of the options as modified; an accounting of all profits realized by optionees whose options had been modified; and an accounting by defendants for all losses sustained by Vornado as a result of the matters set forth. (13a-14a)

Each of the defendants, including Vornado, joined in a motion on March 12, 1973, for an order pursuant to Rule 12(b) and 56 of the Federal Rulces of Civil Procedure dismissing the complaint on the ground that it failed to state a claim upon which relief could be granted; and in the alternative, granting summary judgment to the defendants.*

* This motion was finally withdrawn just prior to the Court's January 16, 1974 decision.

In May of 1973, Judge Sylvester Ryan rendered his decision in Waltzer v. Billera, 72 Civ. 2052 (SJR)*. (139a-153a) Waltzer was an action brought by plaintiff's counsel, Garwin & Bronzaft, on facts and law akin to the Jacoby action. (112a-126a) There, as in Jacoby, defendant corporation (U.S. Industries) had issued five year stock options pursuant to a qualified stock option plan. Later, when the market price of the stock declined below the option price, the corporation amended the outstanding options to permit the exercise of the options at a greatly reduced price for a period commencing with the termination of the original option. Judge Ryan held that the amendments were not countenanced by the plan and that all of the new options granted pursuant thereto were null and void. (148a-150a)

Soon thereafter, at a pre-trial hearing, counsel and the Court agreed to follow the procedure used in Waltzer and try the matter on Stipulated Facts. (35a)

Counsel, after extensive drafting, agreed upon Stipulated Facts. (35a) The facts were supported by fifteen attachments (exhibits) and it was agreed by the parties that the action be adjudicated 'with the same force and effect as if a trial had been held,' and as if the agreed facts and attachments had constituted the evidence at trial. (35a)

* Reported unofficially at CCH Fed. Sec. L. Rep. ¶94,011.

Both sides submitted lengthy memoranda in support of their positions. Defendants' fifty-four page memorandum vigorously sought to distinguish Waltzer, and argued strenuously that the Vornado amendments to the option agreements did not violate Delaware law, §10(b) of the Act, Rule 10(b)-5 or §14 of the Act.

On January 16, 1974, Judge Pierce relying heavily upon Waltzer, found that the January 16, 1970 amendments to the option agreements violated Vornado's 1968 Qualified Stock Option Plan and that the option agreements entered into pursuant thereto were null and void. The Court found further that the acts complained of did not violate Section 10(b), Rule 10(b)-5 promulgated thereunder or Section 14 of the Act. (34a-50a)

The Court granted judgment against the defendants to the extent of voiding each of the January 16, 1970 amendments to the option agreements which had been granted under the 1968 Plan. (51a-53a)

After defendants filed an accounting detailing the fate of the options, both sides agreed that options on 168,000 shares had been voided as a direct consequence of the Court's determination in plaintiff's favor. Although

at the case's outset on December 29, 1972 the market price of Vornado's common stock was higher ($18.125) (Attachment 12 to Stipulation of Facts) than the January 16, 1970 option price ($14.69), on the date of Judge Pierce's decision the market price of Vornado's stock had slipped considerably below $14.69. (98a)

In December, 1974, the Court referred the remaining open issue to Magistrate Goettel for a hearing on plaintiff's application for fees.

Plaintiff's application for an award of attorneys' and accountants' fees of $40,000 plus out-of-pocket disbursements was supported by the affidavit of Bertram Bronzaft sworn to March 27, 1975, wherein the services rendered by plaintiff's attorneys and accountants was listed in detail. (54a-82a)

Defendants' opposition to an award of any fees was predicated on the grounds that the action had bestowed no benefits on Vornado and that the violation of the Plan was 'technical' in nature. (92a-111a)

After a hearing, Magistrate Goettel in his June 25, 1975 Report and Recommendation determined that plaintiff's action had conferred a benefit upon Vornado; that counsel had expended 273 hours in the prosecution

of the action; that plaintiff's fee was to be contingent upon success; that plaintiff's counsel was highly skilled in this area of law and that they "met continuous and determined opposition from experienced counsel." (159a-165a)

The Magistrate further found, on the strength of the applicable case law, that the benefit procured by plaintiff in behalf of Vornado was compensable by an award of counsel fees, even though the benefit did not create a definite fund. The Magistrate determined, however, that the absence of an actual cash fund should affect the size of the attorneys' fee award. He thereupon recommended that a legal fee of "only $10,000 plus disbursements of $211.44 be awarded". (162a-164a)

Thereafter, plaintiff moved to confirm the Magistrate's Report and Recommendation insofar as it held that counsel fees be awarded to plaintiff and to disaffirm the Report and Recommendation as to that portion which recommended a legal fee of $10,000 rather than the $40,000 requested by plaintiff. (166a-175a) Defendants moved to disaffirm the Report and Recommendation on the grounds that no fees should be awarded or, in the alternative, to reduce the amount recommended to be awarded. (176a-178a)

Judge Pierce in a seven page opinion and order dated November 19, 1975 adopted, in effect, Magistrate Goettel's Report both as to its reasoning and its recommendation that plaintiff's counsel be awarded $10,000 plus disbursements. While he held that plaintiff's lawsuit had conferred a substantial benefit upon Vornado, he found that the absence of the creation of a cash fund was the basis for the reduced fees he awarded plaintiff's attorneys. (179a-185a)

## POINT I

### THE VOIDING OF OPTIONS GRANTED UNDER THE AMENDED OPTION AGREEMENTS CONFERRED A SUBSTANTIAL BENEFIT UPON VORNADO AND ITS SHAREHOLDERS

On January 16, 1974, the District Court, per Pierce, J., held that the January 16, 1970 amendment to the outstanding option agreements violated Vornado's 1968 Qualified Stock Option Plan and that the options granted pursuant thereto were null and void. (34a-50a)

It is vital for a thorough understanding of the benefits conferred by plaintiff's action to realize that the wrong complained of occurred on January 16, 1970, the date the outstanding option agreements were improperly amended by the Board of Directors.

On January 16, 1970, Vornado's Stock Option Committee adopted an amendment to the 1968 Plan reducing the price at which options to purchase Vornado common stock could be exercised from prices ranging between $23.00 - $24.57 to $14.69 per share. (23a) The Committee also thereby, extended the period during which these options could be exercised in excess of the time limitation permitted under the 1968 Plan.

Of the four members of the Board of Directors who comprised the Stock Option Committee, three held options to purchase, in the aggregate, 51,000 shares of Vornado stock at prices ranging from $23.00 to $24.57. Two additional members of Vornado's eight man Board, who ratified, adopted and approved the Committee's reducing the option price and extending its term, also held options to purchase 18,000 shares of Vornado stock at $23.00 per share. (31a) Amended options granted by the Board of Directors in violation of the 1968 Plan benefitted, therefore, five of the eight directors of Vornado.

A majority of Vornado's Board of Directors held options to purchase 69,000 shares of stock which were effected by the January 16, 1970 amendment to the option agreements. (31a) As a result of the reduction in the option price to $14.69 from option prices ranging from $23.00 to $24.57, these directors voted themselves a windfall approximating $600,000 (69,000 x. $8.775 average price reduction).

The reduction in the option price from an average of $24.00 per share to $14.69 per share benefitted all optionees in an amount approximating $2,500,000

(approximately 283,000 shares x $8.775 [average reduction]). (21a)

The stockholders of Vornado were neither requested nor gave their approval to the substantial modifications in the existing options. (27a)

Plaintiff contended that the directors-defendants not only enriched themselves in violation of the fiduciary duties that they owed to Vornado, but gave no consideration for the January 16, 1970 modification of their option agreements. (12a)

Judge Pierce stated in his opinion that the amended options were in fact null and void. (48a) On plaintiff's application for reasonable counsel fees, defendants argued that plaintiff should not be awarded <u>any</u> fees since their action conferred <u>no</u> benefit upon Vornado. (92a) Defendants based their opposition to the award of fees on the fact that at the time of Judge Pierce's decision on liability, none of the amended options had been exercised, and that none would be exercised because the option prices exceeded the market price of Vornado stock.

This argument, however, conspicuously ignored the circumstances existing at the time the options were amended and at the time plaintiff interposed her action.

A review of the price range of Vornado stock reveals that the price of the stock, as traded on the New York Stock Exchange, had risen from the price of $14.69 per share on January 16, 1970 to a high of $34.875 on April 12, 1972 (Attachment 12 to Stipulation of Facts). Had the price of Vornado's stock remained at this level, or at any price above the amended option price, the insiders would have been able to realize huge profits by their ultra vires acts.

On the date plaintiff filed her action, the price of Vornado's stock sold for a high of $18-1/8, still considerably above the amended option price of $14.69 (Attachment 12 to Stipulation of Facts).

In light of the foregoing, it is clear that plaintiff benefitted Vornado by correcting corporate misconduct and by preventing the possibility of insiders reaping large profits in violation of a stockholder approved option plan.

On plaintiff's application for an award of counsel and accountants' fees, the Court held that substantial benefits were conferred. (179a) In this respect, the Court's decision is in line with the substantial weight of judicial authority.

For purposes of this brief, plaintiff has

endeavored to limit her discussion of "benefits" to only those cases which closely parallel the facts and law of the case at bar.

In Mencher v. Sachs, 169 A.2d 320 (1960), the Delaware Supreme Court upheld $30,000 in counsel fees awarded plaintiff's counsel in Chancery Court in connection with the cancellation of a block of shares of Seminole Oil & Gas Corporation, allegedly issued in violation of Delaware law. Plaintiff instituted a derivative action shortly after the issuance of the shares in question seeking their cancellation. A Special Master appointed by the Chancery Court, found that the shares had been illegally issued and, as a consequence, the shares were surrendered and cancelled. The defendant appealed the award of counsel fees asserting that no fee could be awarded because the corporation had not received a benefit which could be measured in dollars. Chief Judge Sutherland writing for the Court, stated:

> "A final objection is that there is no 'dollar basis' for measuring any benefit to the corporation resulting from the cancellation of the illegally issued stock or from the termination of the drilling contract. Cancellation of illegally issued stock is in itself a benefit. Although the benefit may be difficult of evaluation in dollars and cents, it is still a benefit." (169 A.2d at 322) (Emphasis added)

Thus, Mencher stands for the propositions that a compensable benefit is conferred by a derivative suit which brings about the cancellation of illegally issued stock and that the corporation is liable for legal fees in such instances.

In an earlier case, Holthusen v. Edward G. Budd Mfg. Co., 55 Supp. 945 (E.D. Pa. 1944), the Court found that plaintiffs were entitled to attorneys' fees for enjoining a corporation from issuing options to executive and administrative employees. The Court initially issued the injunction

> "...for the reason that the value of the options bore no reasonable relationship to the services rendered by the employees to whom they were to be given." 55 F.Supp. at 946.

Subsequently, the board of directors altered the terms of the option grants and the options were issued for a consideration that both the board of directors and the court deemed adequate.

The defendant corporation opposed an award of fees to plaintiff's counsel for a number of reasons including a contention that "there had been no 'fund' recovered against which such allowances may be charged." 55 F.Supp. at 946.

The Court, in answering the corporation's contention, stated:

> "...The fact remains that under the original plan for granting the options there was little, if any, consideration to be received by the defendant from the proposed grantees, although such options undoubtedly had value, and that the plaintiff's action was therefore successful in restraining the corporation from disposing of valuable assets without consideration. To rule that a shareholder who recovers back for his corporation property wrongfully disposed of is entitled to recover his expenses and counsel fees, but that one who prevents such wrongful disposition originally is not so entitled, would establish a distinction tending to discourage a prompt, expeditious and comparatively simple method of restraining corporate abuses in favor of actions, often difficult and costly, to remedy such abuses. With respect to the necessity of a 'fund', there appears to be equally little reason to distinguish between property wrongfully disposed of by a corporation and recovered by means of a shareholder's suit, and property which would have been wrongfully disposed of by the corporation but for a shareholder's suit." (Emphasis added)

In Jacoby, as in Holthusen, the action prevented the issuance of stock options under provisions not contemplated by the stockholders when they approved the plan.

Another decision by the Delaware Supreme Court in McDonnell Douglas Corporation v. Palley, 310 A.2d 635 (Del. Sup. 1973), affirming Palley v. McDonnell Company, 295 A.2d 762 (Del. Ch. 1972), is similarly supportive of plaintiff's position in Jacoby as to compensable benefits and her counsel's right to substantial fees.

In McDonnell, a minority stockholder of a subsidiary corporation insituted suit seeking rescission of sale of its preferred stock to its parent, which suit was mooted by a merger of the subsidiary into another wholly-owned subsidiary of the parent. The merger brought about a result that plaintiff's action had sought.

Plaintiff applied for counsel and accounting fees for the services they rendered during the course of the litigation. The Chancery Court found that plaintiff had had a reasonable chance of success if it had prosecuted its amended complaint which also sought a general accounting on other corporate matters between the subsidiary and parent. Vice Chancellor Marvel found that:

> "....the fact that there is no precise dollar basis for evaluating the benefits gained by the setting aside of the transaction which plaintiff sought to achieve by this action does not mean that the ultimate results of such cause of action were without benefit to the minority stockholders of such corporation, Mencher v. Sachs, 39 Del. Ch. 366, 164 A.2d 320..."

On the question of fees, the Court awarded plaintiff a total of $125,000 for his attorneys' fees plus litigation expenses in excess of $5,000.

McDonnell Douglas appealed the propriety of awarding fees, urging that the cancellation of the preferred

stock did not confer a 'specific and substantial' benefit upon the corporation to warrant the fee award in the Court below. Appellant further argued that the Chancery Court failed to address itself to the question of compensable benefit to the corporation and its stockholders. Justice Herrman, writing for the Delaware Supreme Court, upheld the fee award made by the Vice Chancellor in the following language:

> "It is obvious, we think, that the Court below did consider the requisite element of compensable benefit. After stating its conclusion that application of the 'intrinsic fairness' test [Sinclair Oil Corporation v. Levien, Del. Supr. 280 A.2d 717 (1971)] demonstrated a 'reasonable likelihood existed that plaintiff would have prevailed' if the defendant's ultimate action had not mooted the case, the Chancery Court stated: 295 A.2d at 767
>
> > "* * * And the fact that there is no precise dollar basis for evaluating the benefits gained by the setting aside of the transaction which plaintiff sought to achieve by this action does not mean that the ultimate results of such cause of action were without benefits to the minority stockholders of [Hyson], Mencher v. Sachs, 39 Del.Ch. 366, 164 A.2d 320. Compare Rosenthal v. Burry Biscuit Corporation, 42 Del.Ch. 279, 209 A.2d 459 * * *."
>
> * * *

> [1] It is apparent that the Court below accepted the plaintiff's contention that the cancellation of the Second Preferred Stock effected the rescission sought by the plaintiff; that, consonant with Mencher, such cancellation constituted a compensable benefit. We find no error in this conclusion "

For the sake of brevity, plaintiff respectfully refers this Court to Point II, infra, of this memorandum, for decisions which encompass discussions of both "benefits", and compensation to counsel for conferral of non-pecuniary benefits.

See:

<u>Mills</u> v. <u>Electric Auto-Lite Co.</u>, 396 U.S. 375 (1970).

<u>Merola</u> v. <u>Atlantic Richfield Company</u>, 515 F.2d 165 (3rd Cir. 1975).

<u>Ramey</u> v. <u>Cincinnati Enquirer, Inc</u>., 508 F.2d 1188 (6th Cir. 1974).

<u>Bosch</u> v. <u>Meeker Cooperative Light and Power Association</u>, 257 Minn. 362, 101 N.W.2d 423 (1960)

<u>Abrams</u> v. <u>Textile Realty Corporation</u>, 197 Misc. 25, 93 N.Y.S. 2d 808 (N.Y. Sup. Ct. 1948), 97 N.Y.S. 2d 492 (opinion of Referee)

Certainly, the cases cited heretofore, and in Point II, are strongly supportive of the position taken by Magistrate Goettel, Judge Pierce and plaintiff-appellant that the <u>Jacoby</u> action, in voiding 168,000 illegally issued options, conferred a substantial benefit upon Vornado and its

stockholders. (183a)

## POINT II

### THE ABSENCE OF AN ACTUAL CASH FUND SHOULD NOT ADVERSELY AFFECT THE AWARD OF SUBSTANTIAL ATTORNEYS' FEES

Plaintiff-appellant obviously concurs with the reasoning and the bulk of the derivative case law cited by Judge Pierce in support of his decision that the benefits conferred by the Jacoby action upon Vornado warranted an award of legal fees to plaintiff's counsel. However, while Judge Pierce recognized the principle that benefits achieved by derivative litigation need not result in a pecuniary fund or be one readily calculable in monetary terms in order for plaintiff's counsel to be awarded a fee, he explicitly states that "the absence of an actual cash fund should affect the size of the award." (Emphasis added) (184a)

Plaintiff-appellant contends that Judge Pierce erred, as a matter of law, by considering as a predominant factor in determining an appropriate attorneys' fee award the non-pecuniary aspect of the benefit conferred upon Vornado and its stockholders. It is only this portion of Judge Pierce's opinion which is the subject of this appeal.

Counsel fees incurred in litigation are not ordi-

narily recoverable in the absence of a statute authorizing the payment of fees. The Supreme Court has established, however, that in appropriate situations, pursuant to the historic equity jurisdiction of the federal courts, attorneys' fees are recoverable where a "common fund" has been established for the benefit of a class of persons by virtue of plaintiff's efforts.*

In the landmark case of Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970), the Supreme Court expanded the 'common fund' concept and held that a monetary recovery is not necessary to award counsel fees. The Mills Court's reasoning, particularly as it is pertinent to Jacoby, reads as follows:

> "While the general American rule is that attorneys' fees are not ordinarily recoverable as costs, both the courts and Congress have developed exceptions to this rule for situations in which overriding considerations indicate the need for such a recovery. A primary judge-created exception has been to award expenses where a plaintiff has successfully maintained a suit, usually on behalf of a class, that benefits a group of others in the same manner as himself. See Fleischmann Corp. v. Maier Brewing Co., 386 U.S., at 718-719. To allow the

* Trustees v. Greenough, 105 U.S. 527 (1881); Sprague v. Triconic National Bank, 307 U.S. 161 (1939).

others to obtain full benefit from the plaintiff's efforts without contributing equally to the litigation expenses would be to enrich the others unjustly at the plaintiff's expense. This suit presents such a situation. The dissemination of misleading proxy solicitations was a "deceit practiced on the stockholders as a group," J. I. Case Co. v. Borak, 377 U.S., at 432, and the expenses of petitioners' lawsuit have been incurred for the benefit of the corporation and the other shareholders.

The fact that this suit has not yet produced, and may never produce, a monetary recovery from which the fees could be paid does not preclude an award based on this rationale." (Emphasis supplied) 396 U.S. at 391-92.

* * *

"Other cases have departed further from the traditional metes and bounds of the doctrine, to permit reimbursement in cases where the litigation has conferred a substantial benefit on the members of an ascertainable class, and where the court's jurisdiction over the subject matter of the suit makes possible an award that will operate to spread the costs proportionately among them. This development has been most pronounced in shareholders' derivative actions, where the courts increasingly have recognized that the expenses incurred by one shareholder in the vindication of a corporate right of action can be spread among all shareholders through an award against the corporation, regardless of whether an actual money recovery

has been obtained in the corporation's favor."
(Emphasis supplied)
396 U.S. at 393-94.

Mills stated that the criteria for granting counsel fees is the creation of a 'substantial benefit' to the members of an ascertainable class. The Court relied upon a leading Minnesota case, Bosch v. Meeker Cooperative Light and Power Association, 257 Minn. 362, 101 N.W. 2d 423 (1960), to clarify its usage of "substantial benefit":

> "Where an action by a stockholder results in a substantial benefit to a corporation he should recover his costs and expenses... [A] substantial benefit must be something more than technical in its consequences and be one that accomplishes a result which corrects or prohibits an abuse which would be prejudicial to the rights and interests of the corporation or affect the enjoyment or protection of an essential right to the stockholder's interest."
> Id., at 366-67, 101 N.W. 2d at 426-27.

The Courts in both the Bosch and Mills found conferral of substantial benefits although in neither case was there the creation of an actual cash fund or even the possibility for the creation of a fund.

In <u>Bosch</u>, the plaintiff's action "resulted in a determination that a purported election of directors and a proposed amendment to the corporate by-laws was illegal." 101 N.W. 2d at 425. The Court there noted that while the action did not result in the creation of a cash fund, plaintiff did confer a substantial benefit upon the shareholders by <u>correcting and deterring corporate misconduct</u>.

In <u>Mills</u>, the petitioners demonstrated violations of Section 14(a) of the Act. The Supreme Court, in closing, made the following statement:

> "Whether petitioners are successful in showing a need for significant relief may be a factor in determining whether a further award should later be made. But regardless of the relief granted, private stockholders' actions of this sort 'involve corporate therapeutics', and furnish a benefit to all shareholders by providing an important means of enforcement of the proxy statute. To award attorneys' fees in such a suit to a plaintiff who has succeeded in establishing a cause of action is not to saddle the unsuccessful party with the expenses but to impose them on the class that has benefitted from them and that would have had to pay them had it brought the suit." 396 U.S. at 396-97.

Mills cites a number of decisions at footnotes 19 to 22 at pages 394 and 395, supportive of the principles hereinbefore set forth. One decision we believe particularly relevant is Abrams v. Textile Realty Corporation, 197 Misc. 25, 93 N.Y.S.2d 808 (N.Y. Sup. Ct. 1949); 97 N.Y.S.2d 492 (opinion of Referee).

In Abrams, at 97 N.Y.S.2d 492, 495-96, the Referee awarded reasonable counsel fees to a plaintiff whose action had prevented an ultra vires act. The Referee observed:

> [1] " At common law a stockholder may sue in the corporation's behalf to restrain its commitment to an ultra vires act, and such restraint is deemed in law to be protection of a [illegible] beneficial to the corporation and its stockholders and creditors, even though, from an economic standpoint solely, the proposed act might be advantageous to the corporation. Commitment of a corporation to ultra vires acts, contracts or obligations not only is outside the law but it entails hazards to the corporation, its stockholders and creditors under Articles 6 and 6A of the General Corporation Law and under the common law. Those who have a legal interest in the corporation have a right to judicial protection against such commitment irrespective of whether those hazards or the extra-legal action may be deemed negligible or proper calculated risks, or counter-balanced by desirable ends."
>
> * * *
>
> "Hence, on the narrow issue of law as to 'the right' to an allowance, as distinct from issues of law and fact

as to the amount of allowance, there is no relevance in an argument that this suit created no fund or property for Textile or its security holders, or that they or any of them would have been better off if the ultra vires act had been performed. The law cannot refuse to recognize as beneficial full observance of the law. The law cannot hold that corporate interests are better served by action outside rather than within the law. The law must assume that compliance rather than non-compliance with the careful provisions of the Reorganization Plan and confirmatory court orders better advantaged Textile and its security holders.

In consequence, on the naked issue of the plaintiff's right in law to an allowance, good motives on the part of those planning this mortgage and sincerity of belief in its economic benefits to Textile and its security holders, cannot be controlling or even relevant; and it would beg the question to argue that a validly authorized mortgage on the Dry Dock's terms would have been better for the common interest than continuation of the reorganized mortgage."

Given the defendants' rationale in <u>Jacoby</u> for adopting the January 16, 1970 amendment to the existing option agreements and their adamant opposition throughout to <u>any</u> legal

fees for plaintiff's counsel, plaintiff could not have commissioned better language than the above statement by the Referee.

In a recent case before the Third Circuit, Merola v. Atlantic Richfield Company, 315 F.2d 165 (3rd Cir. 1975), plaintiff secured a settlement which conferred a substantial benefit upon the represented class of persons, the benefit, however, did not create an actual cash fund. The Court, citing Mills, stated:

> "In our opinion, the benefit in this case is clear even though it may be difficult to quantify. We recognize fully the fact that in cases such as this the task of translating the benefit obtained into dollar terms is most difficult at best. (Citations omitted) This difficulty does not, however, justify a niggardly award of attorneys' fees where substantial benefit has been conferred." 595 F.2d at 170 (Emphasis added)

Similarly, the Sixth Circuit in Ramey v. Cincinnati Enquirer, Inc., 508 F.2d 1188 (6th Cir. 1974), awarded substantial attorneys' fees in a case which became moot after trial but before an opinion had been rendered. In Ramey, the plaintiff caused to be set aside repurchase by the corporation

of its own stock because such a repurchase would have been injurious to the corporation and its shareholders. The Court, reflecting on the benefit conferred upon the corporation and the shareholders, stated:

> "Insofar as the derivative actions exposed inaccuracies and misleading statements in the proxy statements in the proxy materials, this litigation constituted 'corporate therapeutics', which benefits both the corporation and its stockholders.
> 508 F.2d at 1194.

Then, citing Mills at length on the issue of fees, the Court stated:

> "We conclude that the services performed by plaintiffs' attorneys justify an award of fees, even though no fund has been brought into court and even though it may be impossible to assign an exact monetary value to the benefit conferred upon the corporation.
> 508 F.2d at 1194.

It is noteworthy that the Court in Ramey approved the District Court's award of $750,000 as attorneys' fees.

A case of particular interest is Denney v. Phillips & Buttorff Corporation, 331 F.2d 249 (6th Cir. 1964). This derivative action was brought to cancel the purchase of

stock by the corporation from its controlling stockholder. Before a trial of the action, the directors rescinded the purchase. As a result of the action, $40,000, in cash, was recovered by the corporation, as well as of course, the return of the money used to pay for the stock.

On an application for counsel fees, defendant-respondent argued that counsel fees could be paid only from the $40,000 cash recovery and thus limited to that amount. The trial court disagreed with respondent's contention and awarded $235,000 in counsel fees and $6,227.98 in expenses. The Circuit Court of Appeals agreed, stating:

> "... the minority stockholders by their actions had benefitted the corporation, it was therefore responsible for proper and reasonable attorney's fees." 331 F.2d at 250.

It is crystal clear from the Court's opinion that the existence or non-existence of a cash benefit did not enter into their determination of an award of fees:

> The trial judge found that the services were of vast proportions and that they were effective. He took into consideration the time spent by the lawyers, the complexity of the legal questions involved, the results accomplished, the professional standing of petitioners, and the professional standing of respondent's lawyers. He viewed the transaction in its entirety based upon all the facts in the case. The judge also took into account the public policy aspect to stockholders' derivative actions, i.e., that they serve a good purpose and should be encouraged rather than discouraged. 331 F.2d at 250.

Another interesting case on the point raised herein is Bailey v. Meister Brau, Inc., 378 F.Supp. 869 (N.D. Ill. 1973). There, plaintiff, a minority shareholder, sued the majority shareholder both derivatively and individually. On the derivative claim the court found for plaintiff on the issue of liability but refused to award damages on that count because the wrongdoer was the majority shareholder of the corporation in whose behalf the benefit was procured. The Court believed that any award of damages to that corporation would unjustly enrich the wrongdoer.

Upon plaintiff's application for an award of attorney's fees, defendants opposed the award on the ground that no damages were awarded to the corporation. The Court, nonetheless, awarded $50,000 in fees, stating that "[t]he mere fact that a monetary award may not be recovered does not preclude an award," p. 885.

Substantial attorneys' fees have consistently been awarded to counsel in non-fund producing derivative actions. See:

> Rafal v. Geneen, CCH Fed. Sec. L. Rep. ¶93,505 ('72-'73 Decisions) (counsel awarded $55,000 for enjoining the election of three nominees of IT&T Board of Directors until additional proxy material concerning §16(b) litigation concerning the three nominees was sent to the shareholders.)
>
> Kramer v. Bruce, 67-910-G (D.C. Mass.) (Not reported) (Counsel awarded $50,000 for correcting certain omissions in an option plan.)

_Mencher_ v. _Sachs_, 164 A.2d 320 (1960) (Counsel awarded $30,000 for cancelling illegally issued stock.)

_McDonnell Douglas_ v. _Palley_, 310 A.2d 635 (Del. Sup. 1973) (Counsel awarded $125,000 after merger mooted plaintiff's claim.)

A simple message may be drawn from a survey of the judicial pronouncements on this point - an actual cash fund is not necessary for the award of substantial attorneys' fees.

Judge Pierce accepts the above reasoning in _Jacoby_, but then makes a distinction between pecuniary and non-pecuniary benefits on the issue of an appropriate attorneys' fee award. In effect, Judge Pierce's decision implies that an attorneys' services are of more value, and hence, deserving of greater compensation, where his efforts create a cash fund. The Court's creation of different scales of compensation for attorneys' fees depending upon the nature of the benefits secured by their efforts seems to infer that derivative actions preventing corporate misconduct or corporate abuse which, by their nature, often do not create cash funds, are not as valuable to the shareholders as actions which recover pecuniary losses suffered by the corporation.

This distinction is wholly untenable. Derivative

suits producing both types of benefits are indispensable to the shareholders. In many cases the 'corporate therapeutics' served by an action, while creating no immediate cash fund, produce long range benefits that insure further well-being and economic growth of the corporation. Benefits which are initially incapable of monetary valuation may ultimately produce millions in tangible funds resulting from the corporate directorship's increased responsiveness to the needs and rights of the shareholders and their increased diligence to their responsibilities as fiduciaries and trustees of the shareholders' interest.

There can be no doubt that derivative suits are the only means to obtain redress for oppressed stockholders whose stakes are too small to warrant individual litigation, and they serve as a prophylactic deterrent against the greed of large corporations and their managements. Moreover, the courts and commentators are uniform in stressing the importance of actions which confer 'therapeutic benefits'. Professor Hornstein has said:

> "The value of class actions, albeit reward inspired, has been repeatedly established in recent decades by shareholders' suits. They are therapeutic, helping to maintain the health of our corporate system. In hundreds of suits which would not have been instituted without the allure of generous compensation, a miscarriage of justice has been prevented. At the same time the record of litigated cases is prophylactic - a

deterrent to future wrongdoing. Every successful suit duly rewarded encourages other suits to redress misconduct and by the same token discourages misconduct which would occasion suit. There can be no doubt that these derivative suits have materially raised the standards of fiduciary relationships and of other economic behavior." Hornstein, "Legal Therapeutics: The 'Salvage Factor' in Counsel Fee Awards, 69 Harv. Law. Rev. 658, 662.

Similarly, the First Circuit Court of Appeals has observed:

"...[I]t is well recognized that the minority stockholder's derivative right of action is not only his legal remedy for corporate mis-management but also is a powerful deterrent to greedy corporate management generally. And this prophylactic aspect of suits of this kind has been held to warrant a liberal attitude in awarding fees." Angoff v. Goldfine, 270 F.2d 185, 192 (1st Cir. 1959).

See also:

In re Osofsky, 50 F.2d 925, 927 (S.D.N.Y. 1931)

Murphy v. North American L. & P. Co., 33 F.Supp. 567, 571 (S.D.N.Y. 1940)

Steinberg v. Hardy, 93 F.Supp. 873 (D.C. Conn 1950).

The indirect or therapeutic benefits flowing to stockholders and investors as a whole from Jacoby, as well as the uniqueness of this litigation and its effect on corporate policies is aptly illustrated by a Dun's Review article entitled

"New Life of Underwater Options". Commenting on the moral of Jacoby and Waltzer v. Billera (U.S. Industries) supra, the article states:

> "Back in 1970, for example, U.S. Industries granted new options at $12 each to executives who already held options on the shares at prices ranging from $20.50 to $34.50. The new options, said the conglomerate, could be exercised as soon as the earlier ones expired. But the USI board did not submit the swap to shareholders for approval. A minority stockholder then sued the company and several top executives on the ground that 'individual defendants were unduly enriched,' which, he said, constituted 'spoliation and waste of the assets' of the company. In a decision handed down in mid-1973, a federal district judge held the option swap null and void - not because it violated any IRS or SEC regulations, but because it contravened the terms of the USI option plan itself.
>
> A case at discount store operator Vornado, involving almost exactly the same circumstances, was decided in the same way last year by another court. The moral of both cases, observes Graef Crystal, vice president of consulting firm Towers, Perrin, Forster & Crosby, is that 'if your company is going to do any swapping, you should look very carefully at your plan and the way it's written. And, to be safe, you ought to consider amending the plan even it that requires stockholder approval." (Emphasis added)

Patently, a textbook illustration of the therapeutic value of the derivative action.

It is crystal clear that the 'therapeutic' benefit of plaintiff's efforts in Jacoby is as important as if the action had resulted in the creation of a cash fund. Certainly,

the absence of a cash fund can not be interpreted to lessen the value of counsel's services.

Neither plaintiff, Judge Pierce, Magistrate Goettel nor defendant has been able to find a single case which has held, or even intimated, that counsel's compensation should be decreased because his efforts conferred a non-pecuniary benefit upon the corporation. The reason for the absence of judicial authority in support of Judge Pierce's premise is obvious - the value of counsel's services to the corporation and its shareholders and the value of the benefit conferred upon them cannot be measured by counting the number of dollars added to the corporate treasury.

A measurable benefit, where available, has been utilized by Courts as a yardstick to aid them in their determination of a reasonable award of counsel fees. Aside from this practical aspect of a cash fund, one would be hard pressed to state categorically that a corporation and its shareholders are enhanced to a greater extent by a cash benefit than by a benefit which is 'therapeutic' in effect.

More important, the question must be posed whether the Courts should discourage stockholder suits aimed at corporate mismanagement and misconduct, the prevention of which would ordinarily not produce cash funds, by rewarding counsel

for services rendered at a lower rate than if their services had procured a measurable dollar benefit.

What, in essence, Judge Pierce's decision signifies, is a partial return to the case law established around the turn of the century. While he does not return full force to the absolute necessity to establish a 'common fund' as a prerequisite to the award of counsel fees (Trustees v. Greenough, supra), he does predicate the amount of the award on the availability of a cash fund. The growth and complexity of modern corporate structures intertwined with the public's interest in honest and fair dealing corporate directorships has encouraged the Courts to expand the areas in which counsel for a group of persons may be awarded fees. A part of this transition has been that non-cash recoveries are as significant as cash recoveries. There is no rational policy reason to divert from this trend now, and no such reason is indicated in Jacoby.

## POINT III

### THE COURT BELOW ERRED IN AWARDING $30 AN HOUR TO PLAINTIFF'S COUNSEL WHO SUCCESSFULLY PROSECUTED A DE NOVO CAUSE OF ACTION

The Court below had determined that plaintiff's counsel and accountants had spent 273 and 55 hours, respectively, in the successful prosecution of this action. The Court further observed that the issues raised by plaintiff, at the outset, involved novel and unique questions of law never before passed upon by any court; that counsel for both sides displayed a high degree of skill and diligence; that plaintiff met vigorous opposition on each and every issue throughout the litigation and that plaintiff's counsel pursued this case on a contingency basis. (161a-162a, 180a)

In City of Detroit v. Grinell Corporation, 495 F.2d 448 (2d Cir. 1974), the Second Circuit set forth the criteria to be considered by the court in determining an appropriate award of counsel fees, namely: time spent by the attorneys on the case; the reasonable hourly rate for such time; and then, to either increase or decrease the sum arrived at by multiplying those two factors by considering less objective factors such as the risk of litigation and the novelty and complexity of the issued litigated.

Implicit in Grinnell, is that counsel who procure a substantial benefit for the corporation, and hence for its shareholders, should be compensated at a reasonable hourly rate for their services. Judge Pierce determined that counsel had conferred a compensable benefit and logically therefore - the next step was to determine a reasonable hourly rate for counsel's services.

Given the Grinnell criteria, it is clear that the Court below examined each of the factors enunciated therein, and, based upon its findings - one result is certain - if any adjustments in the hourly rate were to be made they could only be in plaintiff counsels' favor.

The Court below, however, made one error - the presence of a non-cash benefit seemed to indicate to the Court that a lesser fee was warranted based upon this factor alone. The Court thereupon set aside its own findings as to the skill of counsel; the contingency basis of the fee; the novelty and complexity of the issues involved, and based its award of an admittedly low fee on the "absence" of a cash fund.

Plaintiff believes she has brought forth sufficient law to reveal that substantial counsel fees have and should be awarded in cases which confer non-cash producing benefits. Without again arguing the propriety of Judge Pierce's

reasoning, it must be emphasized that counsel whose efforts nullified, on de novo issues of law, 168,000 options illegally issued by a large public corporation to its officers and directors, thereby deterring corporate misconduct, preventing potential illegal profits by corporate insiders had the Vornado stock risen in price and working on a contingent basis, deserve compensation at a much higher hourly rate than the $30 per hour awarded by Judge Pierce.

Plaintiff's counsel's skill and experience is apparent from their success in this field of law (affidavit of Bertram Bronzaft, 78a-80a). This Court must be aware that $30. is a little more than the prevailing rate charged for the time of para-professionals and law students. If derivative counsel, when successful, are compensated at such unreasonable rates, the small stockholder will have great difficulty to find competent counsel to champion his/her rights.

## CONCLUSION

It is respectfully submitted that this Court reverse so much of the Final Order and Judgment as is necessary to increase the fee awarded to plaintiff's counsel and accountants to a fee of $40,000, together with the disburse-

ments hereinbefore granted by the lower Court.

Respectfully submitted,

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OF COUNSEL:

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Joseph E. Kovacs, Esq.

A 202 Affidavit of Personal Service of Papers LUTZ APPELLATE PRINTERS, INC

**COURT OF APPEALS**
**FOR THE SECOND CIRCUIT**

Index No.

**JACOBY,**
Plaintiff - appellee appellant

- against -

**AVERELL,**
Defendants - appellants - appellee

Affidavit of Personal Service

STATE OF NEW YORK, COUNTY OF NEW YORK ss.:

I, Reuben A. Shearer being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age and resides at 211 West 144th Street, New York, New York 10030

That on the **19th** day of **April** 19 **76** at **450 Park Avenue, New York New York** deponent served the annexed ~~Appendix~~ **Brief** upon **Jack Dashoa** the **Attorney** in this action by delivering 3 true copys thereof to said individual personally. Deponent knew the person so served to be the person mentioned and described in said papers as the herein.

Sworn to before me, this **19th**
day of **April** 19 **76**

Robert T. Brin

Reuben Shearer
Reuben Shearer

ROBERT T. BRIN
NOTARY PUBLIC, State of New York
No. 31-0418950
Qualified in New York County
Commission Expires March 30, 1977